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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2015/2016

BEC1624 – MACROECONOMICS
(All sections / Groups)

29 FEBRUARY 2016
9.00 a.m. – 12.00 p.m.
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of 3 pages with 5 questions only.
2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

(a) Why is productivity the key determinant of a country's standard of living? (5 marks)

(b) Describe the difference between human capital and technology in determining the productivity of a country. (5 marks)

(c) The demand for loanable funds slopes downward and the supply of loanable funds slopes upward. Explain this statement. (5 marks)

(d) What happens to interest rates and investment if the government budget goes from a deficit to a surplus? Explain using an appropriate diagram representing the market for loanable funds. (5 marks)

(Total: 20 marks)

QUESTION 2

(a) Using the money market graph, demonstrate what happens to the money supply, money demand, value of money, and price level if
 (i) the Bank Negara sells government bonds.
 (ii) people decide to demand less money at each value of money. (10 marks)

(b) When the central bank of Malaysia, Bank Negara, increases the money supply rapidly, the result is a high level of inflation. Explain this statement based on the quantity of money equation: $M \times V = P \times Y$. (6 marks)

(c) Economists have identified Shoeleather costs and Menu costs as the costs of inflation. Explain these two costs. (4 marks)

(Total: 20 marks)

QUESTION 3

(a) The hypothetical information in the following table shows Malaysia's economic condition without implementing any fiscal policy:

Year	Potential GDP	Real GDP	Price Level
2014	RM10.4 billion	RM10.4 billion	110.0
2015	RM10.75 billion	RM10.4 billion	113.5

Continued...

(i) If the government of Malaysia wants to keep real GDP at its potential level in 2015, should it use an expansionary policy or contractionary policy? (3 marks)

(ii) If the government of Malaysia is successful in keeping real GDP at its potential level in 2015, discuss what would happen to the level of real GDP, potential GDP, inflation rate, and unemployment rate. (3 marks)

(iii) Draw the aggregate demand and aggregate supply curves to illustrate the impacts and changes in (ii). Be certain to include long-run aggregate supply (LRAS) curves for 2014 and 2015; Short-run aggregate supply (SRAS) curves for 2014 and 2015; aggregate demand (AD) curves for 2014 and 2015, with and without fiscal policy action; and equilibrium real GDP and the price level in 2015, with and without fiscal policy. (4 marks)

(b) Australia's budget deficit to blow out by additional \$38 Billion by 2019, report finds

Budget deficits to 2018-19 will blow out to \$38 billion larger than expected, says a Deloitte Access Economics report, which blames the China slowdown and "gridlock" in the Senate for a cut in revenue.

Source: The Guardian, 29 November 2015.

Discuss the impact of government budget deficit on Australia's open economy. Include a three-panel diagram, the market for loanable funds, net capital outflow and the market for foreign currency exchange to demonstrate the effects. (10 marks)
(Total: 20 marks)

QUESTION 4

(a) Suppose you are a member of the Board of Governors of the Bank Negara Malaysia (BNM). The economy is experiencing a situation where people love to hold money rather than deposit it in the bank. What changes in (i) the reserve ratio, (ii) the discount rate, and (iii) open-market operations would you recommend to increase the growth in the economy? Explain in each case how the change you advocate would affect commercial bank reserves, the money supply, interest rates, and aggregate demand. (15 marks)

(b) Suppose the government reduces taxes by RM10 billion, with no crowding out, and that the marginal propensity to consume (MPC) is 0.75.

Continued...

(i) What is the total effect of the tax reduction on aggregate demand?
(2 marks)

(ii) How does the total effect of this RM10 billion tax cut compare to the total effect of a RM10 billion increases in government expenditures? Explain.
(3 marks)

(Total: 20 marks)

QUESTION 5

Read this article and answer the following questions.

"September inflation rises 2.6%"

PETALING JAYA: The consumer price index (CPI) for September 2015 rose by 2.6% to 113.6 compared with 110.7 in the same month last year. According to the Statistics Department in a press release the rise in CPI was due to increases in the index for alcoholic beverages and tobacco group by 9.8%; miscellaneous goods and services 5.6%; health, restaurants and hotels by 4.6%. The food and non-alcoholic beverages 4.3%, and furnishing, household equipment and routine household maintenance 3.7%. "These five groups of goods and services which weighted 47.4 contributed 86.6% to the increase in the CPI for the month of September 2015," the Statistics Department said in the statement..."

Source: The Star, October 24, 2015

(a) Define the term consumer price index (CPI), and how this index is calculated?
(3 marks)

(b) From the article, what is the percentage change in the consumer price index?
(2 marks)

(c) In your opinion, should policymakers be concerned about the increase in the consumer price index (CPI)? Explain based on your understanding in:

- (i) the Phillips curve theory
(3 marks)
- (ii) the Public policy to raise productivity and living standards
(3 marks)

(d) The consumer price index (CPI) is not a perfect measure of the cost of living. Three problems with the index are widely acknowledged but difficult to solve. Discuss.
(9 marks)

(Total: 20 marks)

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